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No. 83-1308

In the Supreme Court of the United States

OCTOBER TERM, 1983

STRICK CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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Petitioner challenges the court of appeals' determination as to the proper method of computing, and the proper time for collecting, the manufacturers excise tax imposed by Section 4061 of the Internal Revenue Code. The decision below is correct and does not conflict with that of any other circuit. There is no basis for review by this Court.

1.a. Petitioner is a corporation engaged primarily in the manufacture of trucks and trailers. Petitioner incurs higher manufacturing costs than some of its larger, vertically-integrated competitors, since it purchases many of its parts from outside suppliers rather than fabricating them itself (Pet. App. A20). During 1972-1978, petitioner sold substantially all its trucks and trailers at retail, that is, directly to ultimate users (*id.* at A17).

Section 4061(a)(1) of the Code[1] imposes an excise tax on trucks and trailers "sold by the manufacturer." The tax is ordinarily levied on the manufacturer's wholesale selling price. Where a manufacturer sells at retail, Section 4216(b)(1)(A) provides that the tax shall be levied on a constructive wholesale price, "as determined by the Secretary." Pursuant to this grant of authority, the Commissioner in 1954 promulgated a revenue ruling defining the constructive wholesale price as "75 percent of the established retail price," but in no event less than the manufacturer's actual cost of production. Rev. Rul. 54-61, 1954-1 C.B. 259, 260. The requirement that the constructive selling price may not be less than the manufacturer's actual cost of production is generally called the "cost-floor alternative."

Because petitioner sold trucks and trailers almost exclusively at retail during 1972-1978, its excise tax for those years was required to be computed by reference to the constructive wholesale price described above. Since petitioner was a relatively high-cost manufacturer, its manufacturing costs generally exceeded "75 percent of the established retail price," and it thus paid excise tax based on its actual cost (Pet. App. A18). Many of petitioner's lower-cost competitors, by contrast, while selling trailers similar to petitioner's, paid excise tax based on "75 percent of the established retail price," and thus paid less excise tax per vehicle than petitioner did (*id.* at A20).

b. Until 1974, petitioner both sold and leased trailers directly to ultimate users (Pet. App. A32). In 1974, petitioner's parent corporation revived another subsidiary, Cotco Leasing Company, to assume petitioner's financing and leasing functions. Under the new arrangement, petitioner sold trailers to Cotco at an arm's-length price, receiving by

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[1]Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

way of payment cash that Cotco had borrowed from various lenders. Cotco then leased the trailers to ultimate users, assigning the leases to its lenders as security for the loans (*ibid.*). Title to the trailers passed to Cotco, and remained in Cotco subject to the lenders' security interests (*id.* at A32-A33). The principal reason for this new arrangement was to accommodate the lenders' demands that their collateral be insulated from the claims of petitioner's other creditors (*id.* at A33).

Liability for the excise tax generally arises upon the manufacturer's sale of the truck or trailer, provided that payment has been received and title has passed to the purchaser (I.R.C. § 4216(c)). A lease is generally considered a sale (I.R.C. § 4217(a)). In the case of a lease, however, the manufacturer's liability to pay the tax does not arise at once, but arises ratably as installments are received under the lease (I.R.C. § 4217(b)).

On its tax returns for 1974-1978, petitioner reported its transactions with Cotco as sales, and accordingly reported the excise tax attributable to those sales as due in full upon receipt of payment from Cotco (Pet. App. A34). Petitioner subsequently filed a claim for refund, contending that Cotco's existence should be ignored and that its transactions with Cotco, rather than being "sales" on which tax was immediately due, were but the first steps in an overall lease transaction on which tax should be deferred until Cotco received payments from its lessees (*id.* at A32-A34). The Commissioner denied the refund claim, taking the position that Cotco's separate existence had to be respected, that petitioner had sold the trailers to Cotco, and that, title having passed, petitioner was liable for excise tax as soon as Cotco tendered payment to it.

2. Petitioner filed this refund suit in the United States District Court for the Eastern District of Pennsylvania, challenging the "cost-floor alternative" method of computing its excise tax and challenging the Commissioner's characterization of the Cotco transactions as "sales." On the former issue, the district court agreed with petitioner, concluding that the cost-floor method impermissibly "discriminate[d] against * * * low profit margin manufacturer[s] and [imposed] a non-uniform tax among competitors," contrary to Congress's intention that the excise tax "be neutral with regard to competition within the auto industry." Pet. App. A4-A5, citing S. Rep. 91-1444, 91st Cong., 2d Sess. 20-26 (1970). On the latter issue, the district court agreed with the government, holding that the Cotco transactions were "sales" on which petitioner's excise tax liability immediately arose.

On cross appeals from the district court's judgment, the court of appeals sustained the government's position on both issues. As to the issue of tax computation, the court noted that "[t]he plain language of the statute," providing that the excise tax base shall be "as determined by the Secretary" (I.R.C. § 4216(b)), vests the Commissioner with "broad discretion in fixing a constructive sales price" (Pet. App. A22). The court held that the Commissioner had properly exercised his discretion here, since his definition of the constructive wholesale price "harmonize[d] with the origin and purpose of the statute" (*id.* at A25). Section 4216's purpose, the court observed, was "to approximate a wholesale price for a manufacturer selling only at retail," and in adopting the cost-floor alternative the Commissioner simply "ma[de] the reasonable assumption that a manufacturer will set his wholesale price to recover at least his cost of production" (Pet. App. A25). The court found no merit in petitioner's argument that the cost-floor alternative impermissibly "discriminate[d] against the low-profit

margin manufacturer" (*id.* at A27), concluding that Congress, in designing a tax-neutral pricing system, was concerned with uniformity "between manufacturers selling at wholesale and those selling at retail" (*id.* at A19), not with "uniformity despite costs" (*id.* at A27).

As to the timing of petitioner's tax liability, the court of appeals noted (Pet. App. A35) the settled rule that a corporation established (as Cotco concededly was) for substantial and legitimate business reasons must be treated for federal tax purposes as "a separate taxable entity." *Moline Properties, Inc.* v. *Commissioner*, 319 U.S. 436, 438-439 (1943). Having voluntarily structured its transactions with Cotco as sales, petitioner was bound by the form of those transactions for tax purposes (Pet. App. A40-A41). And even if it were proper "to focus on the substance of the relationships here rather than the form" (*id.* at A41), the court concluded that petitioner should not be allowed the "windfall" of paying its excise tax ratably, as if it had leased the trailers, since the corporate structure permitted it to receive full payment at once, without the burden of undertaking any corresponding obligations to Cotco's lenders (*id.* at A41-A43).

3. The court below properly rejected petitioner's challenge to the cost-floor method of computing the manufacturers excise tax. The purpose of Section 4216(b) is to construct an artificial wholesale price for those manufacturers who, selling exclusively at retail, have no actual wholesale prices. The statute in terms provides that this constructive price shall be "as determined by the Secretary,"[2] and the legislative history explicitly states that the

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[2]Petitioner errs in contending (Pet. 7-8) that the court of appeals paid "excessive deference" to the Commissioner's determination, embodied as it was in a revenue ruling rather than in a Treasury Regulation. The court below explicitly acknowledged (Pet App. A21) that, "although a revenue ruling may provide some guidance, it is not entitled to the same deference

Secretary in his discretion may establish that price, inter alia, by "building up from cost of production." H.R. Rep. 708, 72d Cong., 1st Sess. 32-33 (1939). In specifying that the constructive wholesale price may not be less than the cost of production, the Commissioner's cost-floor interpretation also comports with common sense, for a contrary conclusion would have rested on the premise "that it is a general practice for manufacturers to sell below their cost," a notion at odds with "common dealings in the business world" (Pet. App. A25). The cost-floor alternative had been in place for 25 years as of the tax periods at issue here and had been repeatedly reaffirmed by the IRS. *E.g.*, Rev. Rul. 68-519, 1968-2 C.B. 513; Rev. Rul. 68-202, 1968-1 C.B. 477. It has been sustained by the only other court of appeals that has considered the question directly. *Whattoff* v. *United States*, 355 F.2d 473 (8th Cir. 1966).

There is no merit to petitioner's contention (Pet. 9) that the cost-floor method impermissibly prescribed a "discriminatory basis for tax computation in the highly competitive trailer industry." Although Congress did intend that the excise tax should not discriminate among competitors, the tax neutrality Congress enjoined, as noted succinctly below,

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which is extended to a treasury regulation." Moreover, the circumstances under which Revenue Ruling 54-61 was issued endow it with particular persuasive force. Section 4216(b)(1) provides that the constructive price shall be "as determined by the Secretary." Pursuant to that statute, the Secretary issued regulations providing that, where a manufacturer "has no * * * sales to wholesale distributors, a fair market price will be determined by the Commissioner." Treas. Reg. § 148.1-5(b)(1). Pursuant to that Regulation, the Commissioner issued Revenue Ruling 54-61, providing that the "determination [required by Section 4216(b)(1)] has been made with respect to truck or truck trailer bodies and it has been found to represent 75 percent of the established retail price," subject to the cost-floor alternative. 1954-1 C.B. at 260. Given these successive and explicit delegations of authority, the revenue ruling was plainly entitled to at least the degree of deference the court of appeals gave it.

was "uniformity despite sales methods, not uniformity despite costs" (Pet. App. A27). The legislative history reveals a congressional design that "[e]ach member of a competitive group must pay [tax] upon substantially the same basis as all his competitors, even though his sales methods may differ." H.R. Rep. 708, *supra*, at 32-33. The reports accompanying the 1958 amendments emphasize that the tax on a given product should not vary "merely because one manufacturer chooses to sell his article to a retailer or consumer while the other sells his to a wholesaler." H.R. Rep. 481, 85th Cong., 2d Sess. 21 (1958); S. Rep. 2090, 85th Cong., 2d Sess. 22 (1958). In short, Congress aimed to avoid inequalities "between manufacturers selling at wholesale and those selling at retail" (Pet. App. A19), not to eliminate distinctions caused by manufacturers' varying levels of cost efficiency. It is of course true, as the court below acknowledged, that "[a] cost based constructive wholesale price does impose a disparate economic burden on a high-cost manufacturer" (*id.* at A31), but the same objection could be raised against any sales tax. As this Court has stated in a similar context, "Congressional statements relating to the desirability of eliminating discriminations against manufacturers making retail sales cannot be taken as evidence of a desire to prevent the natural inequalities that result when a tax is placed on the wholesale selling price." *Fitch Co.* v. *United States*, 323 U.S. 582, 587-588 (1945) (footnote omitted).

At all events, Congress has eliminated the use of the cost-floor method in computing the manufacturers excise tax for taxable years after 1978.[3] The question whether the

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[3]As petitioner notes (Pet. 10 n.5), Congress in 1978 amended Section 4216 to preclude use of the cost-floor method as an alternative basis for determining the constructive wholesale price, providing that the Secretary henceforth was to compute that figure as a percentage of the established retail price, "determined without regard to any individual manufacturer's or producer's cost." Act of Oct. 14, 1978, Pub. L.

Commissioner correctly interpreted the superseded statutory provision does not warrant this Court's review in the absence of a conflict in the circuits.

4. The court of appeals also ruled correctly that petitioner's transactions with Cotco must be treated as sales in determining the timing of petitioner's excise tax liability. In *Moline Properties*, this Court held that, "[w]hether the purpose [of incorporation is] to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors * * *, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity." 319 U.S. at 438-439 (footnote omitted). Once "the taxpayer ha[s] adopted the corporate form for purposes of his own," the Court reasoned, "[t]he choice of the advantages of incorporation * * * require[s] the acceptance of the tax disadvantages" (*id.* at 439).

There is no dispute in this case that Cotco "was established as a separate corporate entity for substantial and legitimate business purposes" (Pet. App. A36). Indeed, Cotco was established for one of the purposes explicitly

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No. 95-458, § 1(a), 92 Stat. 1255, amending I.R.C. § 4216(b)(1) (penultimate sentence). Petitioner's reliance (Pet. 9 n.3, 10 n.5) on the legislative history of the 1978 amendment in support of its position here, however, is misplaced. The reports on that legislation expressly state that no inference is to be drawn therefrom "with regard to controversies between taxpayers and the Service concerning either the validity of the cost-floor rule or determinations of cost for taxable transactions which occurred before the effective date of the legislation." S. Rep. 95-1127, 95th Cong., 2d Sess. 4 (1978). As the court of appeals properly held, the fact that "Congress saw fit to alleviate in 1978 the burden placed on the high cost manufacturer by the cost-floor alternative does not mean that the Commissioner improperly exercised his discretionary authority at the time Revenue Ruling 54-61 was promulgated." Pet. App. A32, citing *United States* v. *Price*, 361 U.S. 304 (1960).

mentioned by this Court in *Moline Properties* — "to comply with the demands of creditors" (319 U.S. at 438). Cotco engaged in consistent and significant business activity: it borrowed funds from eight banks, to which it alone was liable for repayment; it entered into numerous lease contracts and retained the resulting lease payments; it held title to the trailers it purchased from petitioner and maintained a substantial shareholder's equity account. Under *Moline Properties*, these undisputed facts compel recognition of Cotco's separate existence for tax purposes, and require that petitioner's sales to Cotco be given tax effect. Having "chosen to do business as separate entities," petitioner and Cotco "should be estopped from contending that their relationship was a sham and that they should be treated as one and the same" (Pet. App. A41).[4]

Petitioner errs in contending (Pet. 11) that the decision below conflicts with IRS rulings holding that the Commissioner, in determining the tax consequences of a given transaction, is not bound by the form the taxpayer has chosen. These rulings, as the court of appeals observed, reflect "the recognized exception to the *Moline* rule that the Commissioner may disregard the corporate form in order to avoid a fraud on the taxing statute." Pet. App. A38, citing *Moline Properties*, 319 U.S. at 439. The courts have routinely held that the "form vs. substance" doctrine is not necessarily a two-way street — that taxpayers are generally bound by the form of their transactions, whereas the Commissioner is not, since "taxpayers have it within their own

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[4]Petitioner appears to contend (Pet. 11) that the *Moline Properties* doctrine applies only in the income tax area and has no application to excise tax cases. Petitioner offers no justification for thus limiting the doctrine, and logic suggests none. The rationale for the doctrine that this Court advanced in *Moline Properties* (see 319 U.S. at 438-439) had nothing to do with the type of tax being imposed, but hinged entirely on the taxpayer's relationship to, and purpose in establishing, the corporation in question.

control to choose in the first place whatever arrangements they care to make." *E.g., Commissioner* v. *Danielson*, 378 F.2d 771, 774-775 (3d Cir. 1967). And even if a taxpayer could properly invoke the "form vs. substance" doctrine in his favor, invocation of that doctrine would not help petitioner here. As the court of appeals noted, the facts of this case —particularly, the fact that petitioner received full payment for the trailers without undertaking any corresponding obligations to Cotco's lenders — "indicate that the separation between [petitioner and Cotco] and the transfers between them had significant economic consequences and were not merely a matter of form" (Pet. App. A42). The court of appeals thus properly held (*ibid.*) that petitioner could not prevail even if its "substance over form argument" were accepted.[5]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

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[5]Contrary to petitioner's assertion (Pet. 10-11, 12), the decision below does not conflict with *Hoffman Motors Corp.* v. *United States*, 473 F.2d 254 (2d Cir. 1973). The Second Circuit there said that, in assessing the tax consequences of a transaction, it is immaterial "whether probing form for substance leads to a decision favorable to the Government or to the taxpayer" (473 F.2d at 257). As noted in the text, the court of appeals here did examine the substance of the transactions, and concluded that those transactions were "sales" in substance as well as in form.

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